Arsenal Energy Inc.

2003
Annual Report

To the Shareholders

To the Shareholders

This past year marked the first complete year of operations for Arsenal Energy Inc. Your company participated in the drilling of 15 wells (4.775 net) resulting in nine oil wells, two potential gas wells, and four cased wells awaiting completion in the new year. Arsenal now has purchased or leased 32,400 gross acres (8,100 acres net) of petroleum and natural gas leases for exploration purposes coupled with a potential to earn a further 89,600 gross acres (22,400 acres net) through drilling. We now have access to lands through which to continue exploration efforts for oil and natural gas for the next two years.

Arsenal acquired cash and a strong shareholder base in Legend Capital Corp. during the year and also acquired Orange Energy Inc. subsequent to year end, which had holdings in the natural gas exploration play in southern Saskatchewan. Both of these transactions were for common shares of Arsenal. We welcome the new shareholders of Arsenal and look forward to their support to help us build the Company.

We recorded a profit of $ 104,599 during year ($ 0.02 per share) as opposed to a loss of $150,912 ($0.03 per share) in 2002. Output from our initial Kerrobert oil wells was impacted by adverse spring weather and the second set of wells came on somewhat later than planned. Despite this, we generated $578,195 before general and administration, depletion and depreciation and interest. However, we incurred relatively large legal and accounting costs associated with the merger, acquisition and financing activities resulting in a loss before tax. This was more than offset by a positive impact on the financial statements of the recognition, due to flow through share offerings, of prior years' tax losses.

Arsenal did take positive steps to enhance its financial position by converting $310,000 in promissory notes to common shares during the last quarter. We also raised $1,400,000 in a private placement of flow through shares in late December.

Arsenal is moving forward with activities such as our exploration in southern Saskatchewan, and the recently announced potential light oil production purchase deal in North Dakota. These endeavours should achieve output and earnings growth from our existing base while actively lowering our overall overhead costs on a per barrel basis. We look forward to reporting on our progress throughout 2004.

On behalf of the Board of Directors,

Michael S. Vandale
President

Management Discussion and Analysis
For the year ended December 31, 2003

The following information has been prepared by management to be read in conjunction with the audited financial statements for the year ended December 31, 2003. All values are expressed in Canadian dollars.

Highlights of 2003

- On May 29, 2003, Arsenal completed a merger with Legend Capital Corp. through which the shareholder base and working capital position was enhanced through the receipt of $257,455.
- In June, 2003 Arsenal participated in the drilling of nine wells in the Kerrobert, Saskatchewan area resulting in the completion of nine producing light oil wells in which Arsenal holds a 37.5% working interest. Production and sales from the wells commenced in September, 2003.
- In August, 2003 Arsenal entered into a drilling program in southern Saskatchewan. Five wells, of which the first two were at no cost to Arsenal, were drilled and subsequently evaluated with one test showing an initial flow rate of 176 mcf per day. Subsequent to the year-end, the acquisition of Orange Exploration Inc. increased Arsenal's interest in the prospect by 10% and added holdings of 12,640 net acres.
- In December, 2003 Arsenal completed a settlement of debt in the amount of $310,000 through the issuance of 775,000 shares at $0.40 per share. The cash received as shareholders loans was used to meet commitments without incurring further interest expense that would result from utilizing an increased bank loan.
- In December, 2003 Arsenal completed a private placement financing consisting of 2,000,000 flow-through common shares at $0.70 per share for gross proceeds of $1,400,000.

Petroleum and Natural Gas Revenues

In 2003, Arsenal's gross sales revenue of $984,587 was comprised of 3,367.9 m^3 of oil, 18.8 m^3 of petroleum fluids, 61.5 10^3m^3 of natural gas equating to 60 barrels of oil equivalent per day.

Commodity Pricing and Marketing

Prices received for crude oil and petroleum fluid sales averaged $42.84 and $32.55 per barrel respectively. Natural gas sales averaged $6.49 per mcf. Arsenal sales are at spot reference prices and the company does not currently engage in hedging contracts.

Royalties

Arsenal's current oil and natural gas production is on freehold land subject to royalties averaging 16.9%.

Operating Expense

Field production operating expenses for the year averaged $12.00 per barrel of oil equivalent. Although well within industry standards, Arsenal will continue to monitor operations and promote possible cost saving measures.

General and Administrative Costs

Total general and administrative costs for 2003 were $491,752 an increase of $332,122 over 2002. In general, all areas of general and administration costs increased due to Arsenal coming forth as a junior oil and gas operating company in the year. Audit and accounting, interest expense, consulting and engineering, exchange listing and transfer agent fees along with legal fees all contributed to the increase. Future costs are expected to remain at the 2003 level with moderate increases associated with growth.

Interest

The interest expense of $36,247 incurred in the year is attributed to a bank loan utilized primarily to fund the drilling and completion of nine wells in the Kerrobert, Saskatchewan area.

Liquidity

At December 31, 2003, Arsenal had $837,019 comprised of cash and accounts receivable, $535,514 in accounts payable and an unused bank line of credit of $670,000. In 2004 Arsenal is required to incur $1,350,000 in capital expenditures to satisfy the $1,400,000 flow-through share obligation.

Reserves

Arsenal's oil and natural gas properties were evaluated by the independent engineering firm of Gilbert Lausten Jung Associates effective January 1, 2004. Arsenal's audit and reserves committee recommended acceptance of the evaluation.
At January 1, 2004 Arsenal reserves were 137,000 barrels of oil equivalent proved producing and 16,000 barrels of oil equivalent probable producing for a total of 153,000 barrels of oil equivalent with a value of $1,297,000 present value discounted at 10%.
A ceiling test performed on December 31, 2003 resulted in no requirement for impairment or write-down of Arsenal asset value.

Outlook

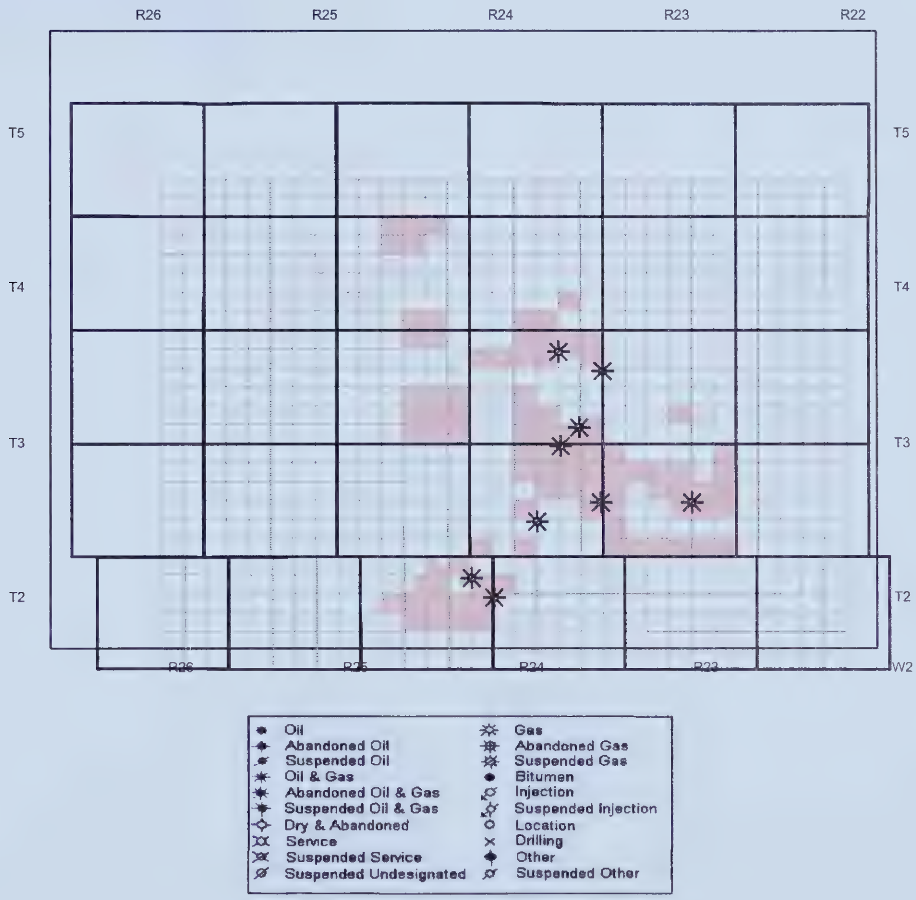
Arsenal continues to work on developing oil and natural gas prospects and identifying acquisition opportunities. Subsequent to year-end, Arsenal entered into a letter agreement to purchase oil and gas properties in North Dakota. The acquisition is subject to certain conditions including a due diligence review by Arsenal. If completed the acquisition will add an estimated 400 barrels of oil equivalent to Arsenal's daily sales with gross revenues of over $5,587,000 per year and a cash flow of $2,200,000 according to an independent third party report.

Also, in May, 2004 Arsenal raised $1,000,000 in a private placement of flow-through shares with Canadian exploratory and development expenditures scheduled for 2005.

Properties

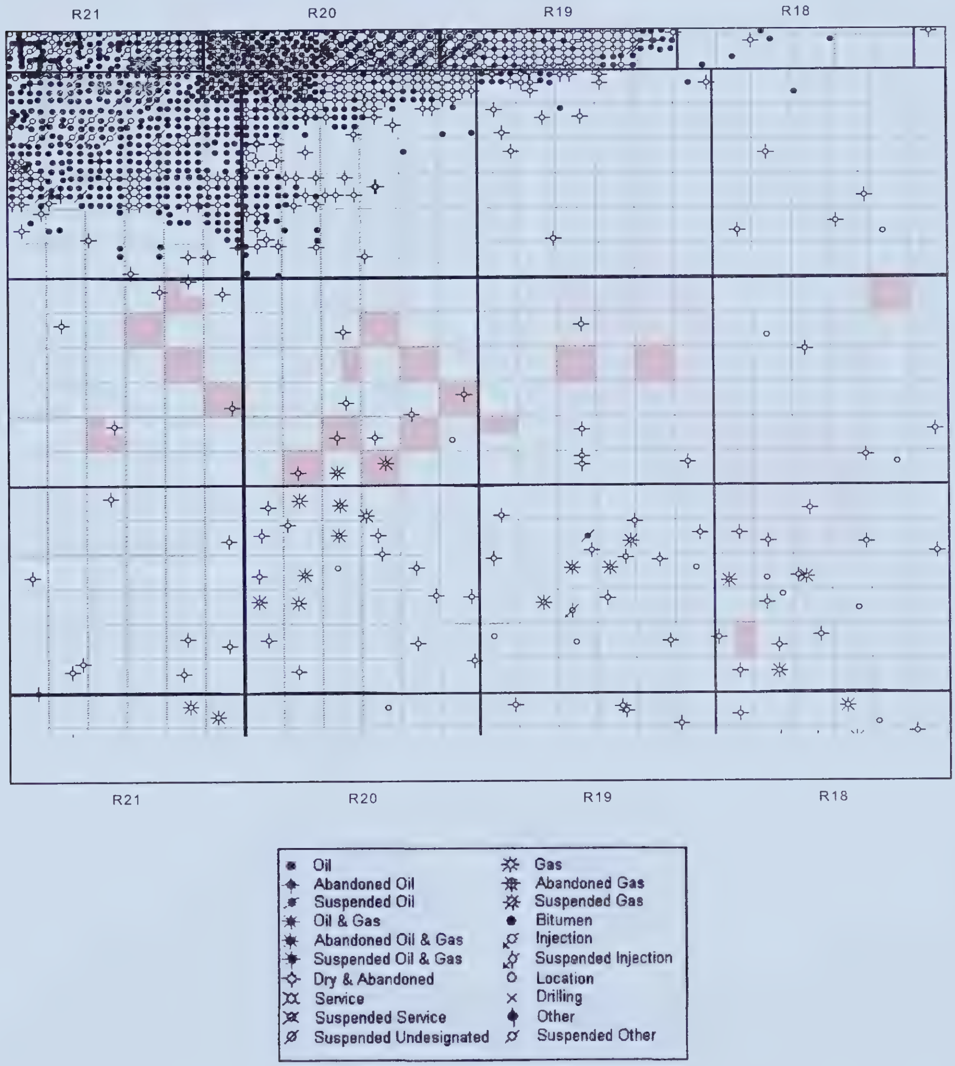
Bengough, Saskatchewan

Arsenal participated in the drilling of five wells (1.25 net) in this potential shallow natural gas exploration play. These wells are rank wildcats in nature and have had some encouraging results, especially from one well which had an initial natural gas test of 176,000 cubic feet per day. Cold weather and inaccessible terrain resulting from heavy snowfall during the past winter hindered operations in the area. Further completion and testing efforts will occur during the summer and fall to further evaluate this exploration effort. Should the further testing and completion efforts encounter success, your company could drill an additional 10 gross wells with its partners (2.5 net). Inaccessibility to pipelines in this area dictates a critical mass of economic gas wells and reserves that are needed prior to this play becoming economic. Arsenal carries approximately 30,000 gross acres (7500 net) of petroleum and natural gas leases in the area with an opportunity to earn a further 64,000 gross acres (16,000 net) through continuous drilling options.



Brock, Saskatchewan

Arsenal is acquiring seismic in this area to help evaluate its lands. Industry drilling offsetting our lands during the past year has given us renewed interest in this area. Natural gas wells are usually completed in the Viking formation, yet interesting results in the Milk River formation have enhanced the economics in this play. Wells in the area are usually only 750 meters deep. Your company intends to drill one well here during the year. Further development will be predicated upon the success of the first appraisal well. Pipeline infrastructure is accessible from our lands.



Kerrobert, Saskatchewan

Arsenal participated in the drilling of nine wells in this play during the year resulting in nine oil wells. We have a 37.5% interest in these wells. The light oil wells in the Viking formation in the Kerrobert pool are typified by flush production coupled by sharp declines until levelling off at low production rates. High world oil prices have made this play attractive. Although Arsenal currently receives most of its oil production from this area, no wells are planned here during 2004.

KPMG LLP

Auditor's Report to the Shareholders

We have audited the balance sheets of Arsenal Energy Inc. (the "Company") as at December 31, 2003 and 2002 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements of free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) "KPMG LLP"
Chartered Accountants

Calgary, Canada
April 26, 2004

Arsenal Energy Inc.

Balance Sheets

December 31, 2003 and 2002

	2003	2002
Assets		
Current assets:		
Cash	$ 743,580	$ 2,991
Accounts receivable	93,439	29,925
	837,019	32,916
Property and equipment (note 5)	1,974,401	998,122
	$ 2,811,420	$ 1,031,038
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 535,514	$ 106,109
Bank loan (note 6)	–	340,000
	535,514	446,109
Future site restoration	9,172	1,000
Future income tax (note 8)	182,000	–
Shareholders' equity:		
Share capital (note 7)	2,163,533	784,027
Contributed surplus	16,700	–
Deficit	(95,499)	(200,098)
	2,084,734	583,929
Commitment (note 10)		
Subsequent events (note 11)		
	$ 2,811,420	$ 1,031,038

See accompanying notes to financial statements.

Approved by the Board:

Director

Director

Statements of Operations and Deficit

Years ended December 31, 2003 and 2002

	2003	2002
Revenue:		
Petroleum and natural gas sales, net of royalties	$ 830,388	$ 50,940
Interest income	–	3,531
	830,388	54,471
Expenses:		
General and administrative	455,505	149,951
Production	252,193	23,253
Depletion, depreciation and site restoration	309,844	22,500
Interest	36,247	9,679
	1,053,789	205,383
Loss before tax	(223,401)	(150,912)
Future income tax reduction (note 8)	328,000	–
Income (loss) for the year	104,599	(150,912)
Deficit, beginning of year	(200,098)	(49,186)
Deficit, end of year	$ (95,499)	$ (200,098)
Income (loss) per share:		
Basic and diluted	$ 0.02	$ (0.03)

See accompanying notes to financial statements.

Arsenal Energy Inc.

Statements of Cash Flows

Years ended December 31, 2003 and 2002

	2003	2002
Cash provided by (used in):		
Operations:		
Net income (loss)	$ 104,599	$ (150,912)
Item not involving cash:		
Depletion, depreciation and site restoration	309,844	22,500
Future income tax reduction	(328,000)	–
Stock based compensation expense	16,700	–
Funds from (used in) operations	103,143	(128,412)
Changes in non-cash working capital	365,891	70,068
	469,034	(58,344)
Financing:		
Increase (decrease) in bank loan	(340,000)	340,000
Issuance of promissory notes	310,000	–
Issuance of shares	1,400,006	–
Share issuance costs	(77,955)	(74,891)
	1,292,051	265,109
Investing:		
Cash acquired on acquisitions (note 3)	257,455	409,748
Acquisition of property and equipment	(1,277,951)	(1,019,622)
	(1,020,496)	(609,874)
Decrease in cash	740,589	(403,109)
Cash, beginning of year	2,991	406,100
Cash, end of year	$ 743,580	$ 2,991
Interest paid	$ 36,247	$ 9,679

Cash includes deposits with maturities of less than 90 days.

See accompanying notes to financial statements.

Notes to Financial Statements

Years ended December 31, 2003 and 2002

1. Incorporation and organization of the Company:

Arsenal Capital Inc. is incorporated under the *Business Corporations Act* (Alberta). During 2002, the Company completed its qualifying transaction and changed its name to Arsenal Energy Inc. (see note 4).

2. Significant accounting policies:

(a) Petroleum and natural gas properties:

The Company follows the full cost method of accounting for petroleum and natural gas properties, whereby all costs of exploring for and developing petroleum and natural gas and related reserves are capitalized by cost centre. Such costs include land acquisition costs, cost of drilling both productive and non-productive wells, and geological and geophysical expenses and related overhead.

Capitalized costs, excluding costs relating to unproven properties, are depleted using the unit of production method based on estimated proven reserves of petroleum and natural gas before royalties as determined by independent petroleum engineers. For purposes of the depletion calculation, natural gas reserves and production are converted to equivalent volumes of crude oil based on relative energy content.

The Company applies a "ceiling test" to capitalized costs to ensure that such costs do not exceed future net revenues from estimated production of proven reserves, using prices and costs in effect at the Company's year end, and the costs of unproven properties less impairment. Future net revenues are undiscounted and are calculated after deducting general and administrative costs, financing costs, income taxes and site restoration and abandonment costs.

Proceeds from the sale of petroleum and natural gas interests are applied against capitalized costs with no gain or loss recognized unless such a sale would significantly alter the rate of depletion and depreciation.

Depreciation of equipment, furniture and leasehold improvements is provided for on a declining balance at a rate of 20% per year.

(b) Interest in joint ventures:

A portion of the Company's petroleum and natural gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

2. Significant accounting policies (continued):

(c) Future site restoration and abandonment costs:

Site restoration and abandonment costs are provided for over the life of the estimated proven reserves on a unit of production basis. Costs are estimated each year by management in consultation with the Company's engineers based on current regulations, costs, technology and industry standards. The period charge is expensed and actual site restoration and abandonment expenditures are charged to the accumulated provision account as incurred.

(d) Use of estimates:

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(e) Per share amounts:

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Weighted average number of shares is determined by relating the portion of time within the reporting period that common shares have been outstanding to the total time in that period.

The Company uses the treasury stock method to determine the dilutive effect of stock options to other dilutive instruments. Under the treasury stock method, only dilutive instruments where the market price exceeds the exercise price impact the diluted calculations.

(f) Stock-based compensation plan:

The Company has a stock-based compensation plan, which is described in note 7. No compensation expense is recognized for these plans when stock options are issued to employees. Any consideration paid by employees on exercise of stock options is credited to share capital. The Company does not purchase stock or stock options from employees as part of its stock-based compensation plan.

(g) Financial instruments:

The Company uses derivative financial instruments from time to time to hedge its exposure to fluctuations in oil and natural gas prices. Gains or losses from these activities are reported as adjustments to the related revenue or expense accounts when a gain or loss is realized.

Notes to Financial Statements

2. Significant accounting policies (continued):

(h) Income taxes:

The Company follows the asset and liability method of tax accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. Future tax assets are recorded only to the extent it is more likely than not these assets will be realized.

(i) Flow-through shares:

Flow-through shares are issued at a fixed price and the proceeds are used to fund qualifying exploration and development expenditures within a defined period. The qualifying expenditure deductions funded by flow-through arrangements are renounced to investors in accordance with Canadian tax legislation. To recognize the foregone tax benefits of flow-through shares, share capital is reduced and a future income tax liability is recorded for the estimated future tax cost of the renounced expenditures, when the expenditures are renounced.

3. Business acquisition:

The Company and Legend Capital Corp. ("Legend") entered into a business combination agreement dated February 4, 2003 which provided for the amalgamation of the Company and Legend.

Pursuant to the agreement, the shareholders of the Company and Legend exchanged their common shares for common shares of a newly amalgamated company, Arsenal Energy Inc. ("Amalco"). The holders of common shares of the Company received one common share of Amalco in exchange for 1.3875 common shares of the Company held and the holders of common shares of Legend received one common share of Amalco for every 2.5625 Legend common shares held.

The acquisition was accounted for using the purchase method with the results of Legend's operations being included from the date of acquisition.:

Net assets acquired:	
Cash and short term deposits	$ 257,455
Consideration:	
Issued 1,165,836 common shares	$ 257,455

Years ended December 31, 2003 and 2002

4. Qualifying transaction:

The following transactions constituted the qualifying transactions of both Arsenal Capital Inc. ("Arsenal") and A.C. Global Capital Corp. ("AC Global") pursuant to Policy 2.4 of the TSX Venture Exchange relating to capital pool companies.

(a) Effective May 1, 2002, Arsenal acquired certain oil and gas interests in properties located in the North Dodsland and Kerrobert areas in west central Saskatchewan. The agreed purchase price was $450,000 subject to closing date adjustments. As closing of the transaction did not occur until October 17, 2002, the purchase price was adjusted for interim period net revenues and costs as follows:

Acquisition price as agreed	$ 450,000
Net adjustments on closing	(39,088)
Acquisition costs	28,748
	$ 439,660

(b) Effective October 18, 2002 Arsenal and AC Global completed their proposed amalgamation. The amalgamation has been treated as a purchase of AC Global by Arsenal. The fair value of the net asset acquired in AC Global was cash of $409,748 and the amalgamated entity issued 3,660,000 common shares as consideration to the shareholders of AC Global.

5. Property and equipment:

2003	Cost	Accumulated depreciation	Net book value
Petroleum and natural gas properties and equipment	$ 2,263,665	$ 316,310	$ 1,947,355
Other equipment	33,908	6,862	27,046
	$ 2,297,573	$ 323,172	$ 1,974,401
2002			
Petroleum and natural gas properties and equipment	$ 1,018,622	$ 21,400	$ 997,222
Other equipment	1,000	100	900
	$ 1,019,622	$ 21,500	$ 998,122

Notes to Financial Statements

5. Property and equipment (continued):

The depletion calculation has excluded unproved properties of $nil in 2003 (2002 - $506,000).

As at December 31, 2003, the estimated future site restoration costs to be accrued over the remaining proved reserves are approximately $62,000 (2002 - $20,000).

6. Bank loan and promissory notes:

The Company has available a demand operating loan facility in the amount of $670,000 bearing interest at the bank prime rate plus 0.5% per annum and is secured by a $5,000,000 demand debenture with a first and floating charge and a general security agreement on all assets.

During 2003, certain insiders were issued non-interest bearing promissory notes totaling $310,000. The notes were then converted to common shares (note 7).

7. Share capital:

(a) Authorized:

(i) Unlimited number of common shares; and

(ii) Unlimited number of preferred shares, issuable in series (of which none have been issued).

(b) Issued common shares:

	Number of shares	Amount
Balance, December 31, 2001	3,750,000	$ 449,170
On amalgamation:		
Issued to Arsenal shareholders	3,000,000	449,170
Issued to AC Global shareholders	3,660,000	409,748
Amalgamation costs	–	(74,891)
Balance, December 31, 2002	6,660,000	784,027
Converted to Arsenal shareholders on amalgamation	(1,860,000)	–
Converted to Legend shareholders on amalgamation	1,165,836	257,455
Share issue costs	–	(77,955)
Tax effect of share issue costs	–	31,000
Settlement of related party debt	775,000	310,000
Private placement of common shares	2,000,000	1,400,006
Tax effect of flow-through shares	–	(541,000)
Balance, December 31, 2003	8,740,836	$ 2,163,533

Years ended December 31, 2003 and 2002

7. Share capital (continued):

(c) Flow through shares:

In December 2003 the Company issued 2,000,000 flow-through shares for proceeds of $1,400,006. The future tax adjustment relating to the flow-through shares of $541,000 has been recorded to future tax liability (note 8). The Company has a commitment to expend $1,400,006 of income tax attributes associated with oil and gas exploration and development activities by December 31, 2004.

(d) Stock options:

The Corporation has a fixed stock option plan in which the Company may grant up to 1,200,000 options to its employees, officers, directors and consultants of the Company. During 2003 the Company granted 974,432 options to officers and directors. The options expire five years from their grant date and have an exercise price of $0.20 per share. The options vested immediately.

Changes in the number of options, with their weighted average exercise price, are summarized below:

	2003		2002	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Stock options outstanding, beginning of year	243,600	$ 0.25	375,000	$ 0.25
Granted	974,432	0.20	–	–
Cancelled or expired	–	–	(56,000)	0.25
Reduction on amalgamation	(68,032)	0.25	(75,400)	0.25
Stock options outstanding, end of year	1,150,000	$ 0.21	243,600	$ 0.25
Exercisable at year end	1,150,000	$ 0.21	243,600	$ 0.25

The weighted average contractual life (years) of the options outstanding at December 31, 2003 is 3.65.

(e) Stock-based compensation:

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2003: zero dividend yield; expected volatility of 80%; risk-free rate of 4.0%; and expected life of 5 years. The weighted average fair value of stock options granted during the year was $0.02 per option.

7. Share capital (continued):

(e) Stock-based compensation (continued):

Had compensation cost for the Company's stock-based compensation plan been determined based on the fair value at the grant dates for awards under the plan after January 1, 2002, the Company's net income and income per share for 2003 would have been $102,800 and $0.02 respectively. These pro forma earnings reflect compensation expense amortized over the options' vesting period.

(f) Per share amounts:

Per share amounts have been calculated on the weighted average number of shares outstanding. The weighted average shares outstanding for the year ended December 31, 2003 was 5,965,439 (2002 – 4,339,973).

In computing diluted earnings per share, 275,712 shares were added to the weighted average number of common shares outstanding during the year ended December 31, 2003 (2002 – nil) for the dilutive effect of stock options.

(g) Conversion of promissory note:

During the year certain insiders and directors of the Company converted $310,000 of their promissory notes to common shares at a price of $0.40 per share. This transaction was recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

8. Income taxes:

Income tax expense differs from the amount that would be computed by applying the Federal and Provincial statutory income tax rates of 40.62% (2002 – 46.12%) to loss before income taxes due to the following:

	2003	2002
Expected income tax reduction	$ (90,745)	$ (69,601)
Increase resulting from:		
Resource allowance	4,000	14,616
Change in valuation allowance	(136,500)	54,985
Stock based compensation	6,800	–
Differences in tax pools	(129,500)	–
Change in tax rate	10,000	–
Other	7,945	–
	$ (328,000)	$ –

Years ended December 31, 2003 and 2002

8. Income taxes (continued):

The tax effects of temporary differences that give rise to significant portions of future tax assets and liabilities at December 31, 2003 and 2002 are presented below:

	2003	2002
Share issue costs	$ 53,000	$ 41,600
Non-capital losses	292,000	85,900
Petroleum and natural gas properties	(527,000)	9,000
Valuation allowance	–	(136,500)
	$ (182,000)	$ –

The non-capital losses expire in 2008 and 2009.

9. Financial instruments:

(a) Fair values of financial assets and liabilities:

Financial instruments consist of cash and short-term deposits, accounts receivable, accounts payable and the bank loan. At December 31, 2003 and 2002 there are no significant differences between the carrying amounts reported on the balance sheet and estimated fair values. The Company has not entered into any hedging contacts.

(b) Credit risk:

A substantial portion of the Company's accounts receivable are with customers and joint venture partners in the petroleum and natural gas industry and are subject to normal industry credit risks. The Company sells substantially all of its production to one primary purchaser under normal industry sale and payment terms. Purchasers of the Company's natural gas, crude oil and natural gas liquids are subject to an internal credit review to minimize the risk of non-payment.

10. Commitment:

The Company has committed to an operating lease for office space at approximately $25,000 per annum to December 31, 2004.

Notes to Financial Statements

Years ended December 31, 2003 and 2002

11. Subsequent events:

(a) The Company completed the acquisition of Orange Exploration Inc. ("Orange") on March 24, 2004. The acquisition is a non-arm's length transaction and the net assets acquired will be recorded at the fair value at the date of acquisition due to the ownership change being substantive and the exchange amount being supported by independent evidence as approved by the Company's independent directors.

As a result of the acquisition, the Company issued an aggregate of 1,850,000 common shares of Arsenal, at the price of $0.50 per common share and an aggregate of 1,200,000 share purchase warrants of the Company, for all of the issued and outstanding shares of Orange. Each warrant is exercisable for 1 common share of the Company at an exercise price of $0.53 per share on or before March 24, 2005.

(b) In March 2004, the Company commenced a private placement financing of 1,000,000 flow-through common shares at $1.00 per share for anticipated gross proceeds of $1,000,000.

(c) The Company entered into a letter agreement to acquire oil and gas properties in the United States for a total consideration of $6.25 million.

The obligations of Arsenal to complete the acquisition are subject to certain conditions, including but not limited to: (i) the parties entering into a formal purchase and sale agreement on or before May 21, 2004 (ii) all necessary regulatory and third party consents, orders, approvals and authorizations as may be required in respect of the proposed acquisition shall have been received; (iii) Arsenal shall have been satisfied with its due diligence review of the North Dakota properties; and (iv) Arsenal shall have obtained the approval of its lending institutions for the financing of the purchase of the North Dakota properties.

Notes

Arsenal Energy Inc.

BOARD OF DIRECTORS	MICHAEL VANDALE President Calgary, Alberta
	Greg Belzberg Los Angeles, California
	William Hews Calgary, Alberta
	David Stadnyk Vancouver, British Columbia
	Errol Stewart Calgary, Alberta
LEGAL	BORDEN LADNER GERVAIS LLP
ACCOUNTING	KPMG LLP
ENGINEERING	GILBERT LAUSTEN JUNG

Arsenal Energy Inc. currently trades on the TSX Venture Exchange under the letters AEI. For further information email us at info@aren.ca, or visit our website at www.aren.ca.